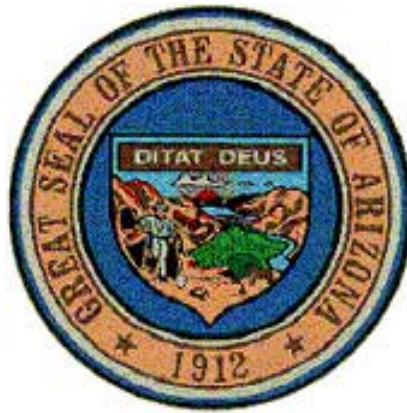

Residential Utility Consumer Office



**Serving the Arizona
Residential Consumer
Since 1983**

**TWENTY-FIRST ANNUAL REPORT
2002-2003**

TABLE OF CONTENTS

DIRECTOR'S LETTER.....	1
RUCO ADMINISTRATIVE AND SUPERVISORY PERSONNEL	2
RUCO'S ORGANIZATION CHART	4
RUCO AND THE REGULATORY PROCESS.....	5
THE RATEMAKING PROCESS	5
RUCO BUDGET	7
RUCO'S FUNDING MECHANISM	7
RUCO'S CASE ANALYSES AND INTERVENTIONS	8
RUCO'S IMPACT	8
CONSUMER EDUCATION AND OUTREACH ACTIVITIES	9
SUMMARY OF MAJOR CASES	
ON-GOING CASES	10
CASES CLOSED IN FY 2003	19
THE RESIDENTIAL UTILITY CONSUMER OFFICE STAFF	25
APPENDIX	26



DIRECTOR'S LETTER

RESIDENTIAL UTILITY CONSUMER OFFICE

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Janet Napolitano
Governor

October 31, 2003

Stephen Ahearn
Director

The Honorable Janet Napolitano, Governor
The Honorable Ken Bennett, President, Arizona Senate
The Honorable Jake Flake, Speaker, Arizona House of Representatives

Re: Introductory Letter for FY 2003 RUCO Annual Report

It is my pleasure to submit this, the 21st Annual Report of RUCO, the Residential Utility Consumer Office. I am also pleased to submit the report electronically, in a manner utilizing available technology that also conserves physical and financial resources.

This Report covers activity of the Office for the Fiscal Year ending June 30, 2003. The section entitled *Case Summaries* also discusses cases open as of July 1, 2003 and so presages Office activity at the outset of Fiscal Year 2004.

The Report tells a story of effective representation of utility consumers' interest before the Arizona Corporation Commission. In one instance, the Commission itself credited RUCO with successful advocacy of a case that will save telecommunications consumers in the future an amount calculated to have a present value of approximately \$227 million (see discussion of USWest Dex case).

Fiscal Year 2004 brings perhaps the greatest and most complex challenge faced by regulatory and consumer advocacy institutions—a full rate case from the state's largest regulated entity, the Arizona Public Service Company. We look forward to full and fair evaluation of that and other cases and, where necessary, an aggressive advocacy of Arizona residential consumer interest.

On a separate note, RUCO and its quite numerous and activist residential constituents are of course grateful the Legislature ultimately declined to remove funding from the Office, as had been originally proposed in early versions of the JLBC budget this most recent session. RUCO is cognizant of the charge to do more with less, and takes seriously the obligation to deliver value for the budget entrusted with the Office.

Sincerely,

Stephen Ahearn

Stephen Ahearn
Director

SA:hs

RUCO ADMINISTRATIVE AND SUPERVISORY PERSONNEL

DIRECTOR

Stephen Ahearn was appointed by Governor Janet Napolitano as Director of the Arizona Residential Utility Consumer Office (RUCO) on January 6, 2003. He is a native Arizonan, born on Davis-Monthan Air Force Base in Tucson, and raised in Phoenix. He received his undergraduate degree (B.A., International Relations) from Pomona College in Claremont, California, and his graduate degree (MBA, International Finance) from UCLA.

Mr. Ahearn spent his early career after undergraduate school in operational, finance and management positions for Los Angeles-based manufacturing firms. In the mid-1980's, he moved back to Arizona and co-founded companies that manufactured non-toxic, environmentally-sensitive pesticides, building materials and recycled plastics products.

In 1990 he joined the Arizona Department of Commerce Energy Office as the Manager of Planning and Policy. In that capacity he was responsible for implementation of the legislatively-mandated state Energy Policy. He began to write and speak extensively about electric industry restructuring as early as 1994, and was recruited to the Arizona Corporation Commission in late 1997 to advise the staff on electric industry competitive matters and to act as the agency's liaison to the Legislature.

He left the staff of the Corporation Commission in late 1999 to run for the office of Corporation Commissioner. In the period just prior to being appointed Director of RUCO, he had founded Ahearn & Associates, a consulting firm specializing in general business planning with a focus on renewable energy project development and representation of renewable energy firms.

DEPUTY DIRECTOR

Ernest Nedd is a native Phoenician and graduate of the Phoenix Elementary School District No. 1 and Phoenix Union High School. He attended Brown University in Providence, RI, and after serving in the U.S. Army, including a tour of duty in Vietnam, Mr. Nedd returned to Arizona and earned a B.S. degree in Political Science from Arizona State University. He then attended the College of Law at Arizona State and earned his J.D. degree in 1976.

Mr. Nedd has previously held positions with the State of Arizona as an Assistant Attorney General, Assistant Commissioner of the Real Estate Department and Chief Hearing Officer of the Department of Liquor Licenses and Control. He has served as a member of the City of Phoenix Board of Adjustment, the Phoenix Inner City Planning Committee and the Phoenix Transportation Advisory Committee. Mr. Nedd also is a former Chairman of the Board of Directors of Valle del Sol, Inc. and he has served on the Board of Directors of the Valley Christian Centers.

Mr. Nedd is currently a resident of the Coronado Historic Neighborhood in Central Phoenix.

CHIEF COUNSEL

Scott Wakefield has been RUCO's Chief Counsel since 1998. He came to RUCO after serving as a Hearing Officer at the Corporation Commission, where he handled numerous rate case proceedings, consumer complaint hearings, and matters involving competition in the utility industry.

Mr. Wakefield is a member of the Lorna Lockwood Inn of Court. He received his Juris Doctorate cum laude from Arizona State University in 1990, and his Bachelor of Science degree in accounting magna cum laude from Arizona State in 1987. He has served on the board of directors for two non-profit organizations, and he currently volunteers with Recording for the Blind and Dyslexic. He grew up and continues to live in Tempe.

Prior to his tenure as a hearing officer, Mr. Wakefield investigated and prosecuted investment fraud with the Corporation Commission's Securities Division. His work there resulted in caselaw outlining when investments in limited liability companies can be considered securities under the Arizona Securities Act.

Mr. Wakefield is knowledgeable on the process to appeal decisions of the Corporation Commission, and lead the first RUCO success in appealing a Commission decision. He participates in RUCO's speaker's bureau, and has made numerous presentations on utility regulation and practice before the Arizona Corporation Commission in legal continuing education seminars.

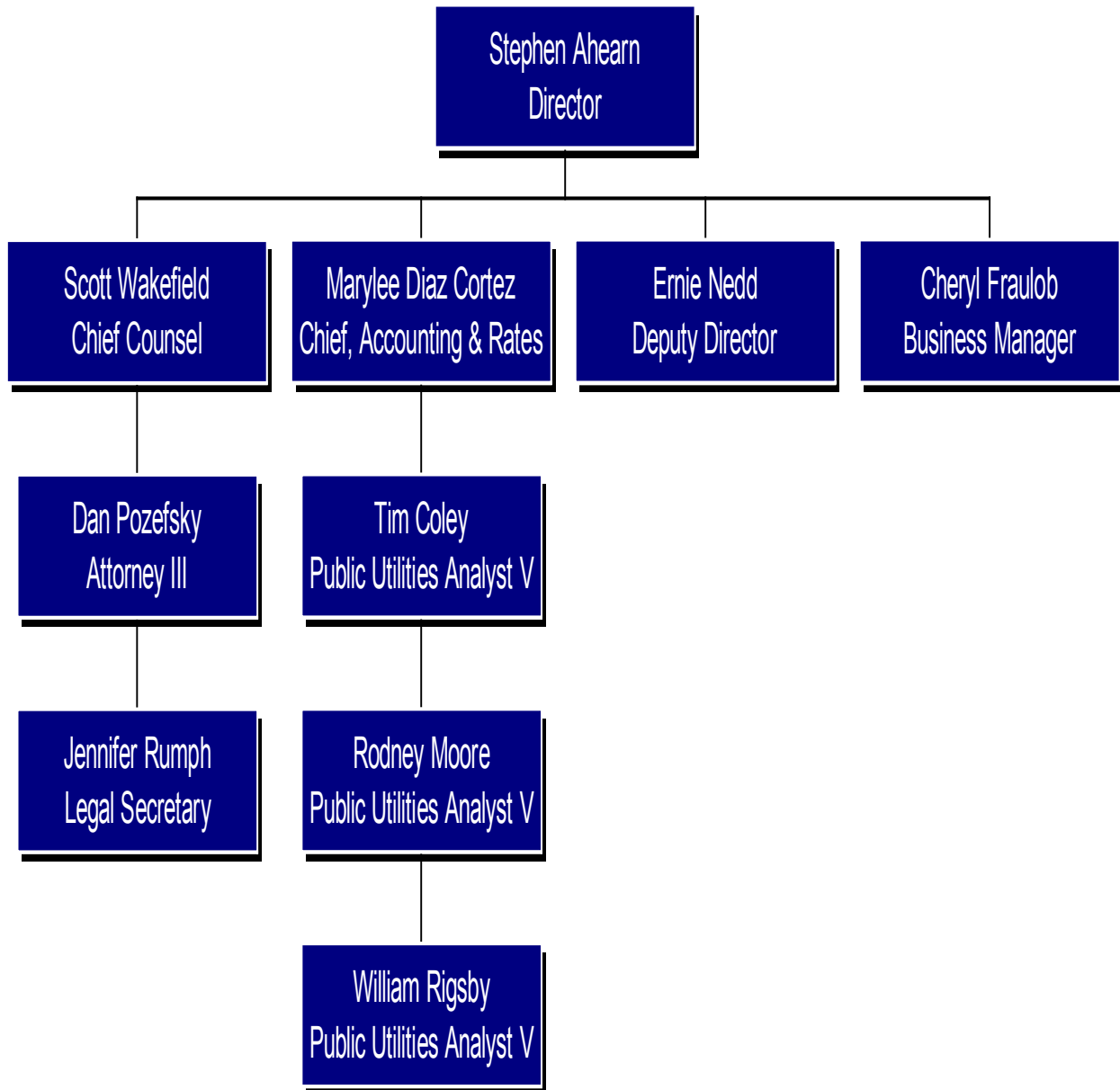
CHIEF ACCOUNTING & RATES

Marylee Diaz Cortez joined the Residential Utility Consumer Office in 1992, and has served as head of the technical division for the past nine years. She is a graduate of the University of Michigan and a Certified Public Accountant licensed in Arizona and Michigan.

Prior to joining RUCO, Ms. Diaz Cortez worked for the public accounting firm of Larkin and Associates in the Detroit, Michigan area. Her private practice included regulatory consulting services. Between her experience at Larkin and Associates and RUCO she has audited over 70 public utility companies including electric, gas, telephone, water, and sewer. She has provided expert testimony in as many cases.

Ms. Diaz Cortez works with a staff of three in-house auditors as well as outside expert witnesses. She is responsible for overseeing all testimony filed before the Arizona Corporation Commission. In her 11 years with RUCO, she has worked diligently and successfully to protect consumers from unjust utility rates.

RUCO'S ORGANIZATION CHART



RUCO AND THE REGULATORY PROCESS

The Residential Utility Consumer Office (RUCO) was established by the Arizona Legislature in 1983 to represent the interests of residential utility ratepayers in rate-related proceedings involving public service corporations before the Arizona Corporation Commission.

Historically, utilities have had the exclusive right to provide services in designated areas. As legal monopolies, utilities are regulated to ensure that the public is charged just and reasonable prices. To establish the utilities' rates and charges, the Commission conducts public hearings and examines evidence and testimony presented by various concerned parties. RUCO represents the interests of Arizona's residents in these proceedings.

Every utility rate increase application filed with the Commission, regardless of the size of the utility, receives a preliminary review by RUCO. As a matter of policy, RUCO always intervenes and participates in rate cases involving Arizona's largest utilities. Intervention in the cases of smaller companies is decided on a case-by-case basis, with particular attention to the size of the increase sought, the rate history of the utility, and the availability of resources at RUCO. Generally, RUCO does not formally intervene in small cases to avoid causing unnecessary legal expenses for the small utility and its ratepayers.

RUCO is authorized 11 full-time employees, and often contracts with consultants for assistance in analyzing utilities' requests for changes in rates and preparing testimony.

THE RATEMAKING PROCESS

The rates charged by Arizona's investor-owned utilities are established by the Commission. The Commission authorizes a utility to charge rates, which will recover expenditures which are appropriate and prudently incurred, and which provide an opportunity to earn fair return on the utility's capital investment.

A utility initiates the process to obtain a rate increase by filing an application with the Commission. The application must be based on a "test year" of actual expenses and investment during a recent twelve-month period. All of the utility's cost data are drawn from its own records. The Commission requires that the utilities follow a standardized system of accounting procedures that assures that the data can be easily reviewed and verified by the Commission, RUCO and others.

In its application, a utility may propose certain adjustments to its actual test year costs and investment. Historical costs and investment may be adjusted by annualizing changes which occurred during the test year, such as payroll increases or tax changes, making them appear as if they had been in effect for the entire year. In addition, historical costs may be normalized to eliminate the effects of abnormal variations that actually occurred during the test year, such as weather-related changes in consumption. Other adjustments may be proposed to include the effects of known and measurable changes that occurred after the end of the test year, such as wage increases and certain costs related to recently completed construction projects.

Upon receiving the utility's application and written summary or testimony, the Commission's Staff reviews the application to confirm that it contains all the necessary accounting information. If the application is complete, the Commission's Staff prepares a letter of sufficiency. The determination of sufficiency triggers the Commission's "time clock" rule,

which establishes a deadline by which the Commission Staff must file its Staff Report or testimony on the application, and a deadline by which the Commission must issue a final order on the application. A hearing date is fixed for an application that requires a hearing.

After the application is determined sufficient, RUCO and other interested parties are permitted to intervene in the case. As intervenors, parties have the right to obtain additional information from the utility to assist in their review of the application. In addition, intervenors may present evidence of their own on the application and may have their attorneys cross-examine other parties' witnesses and submit written briefs, which present their positions on the issues in the case.

When the Commission Staff has completed its investigation, it issues recommendations in a Staff Report or written testimony. Intervenors also provide their recommendations in the form of written testimony prepared by their analysts or consultants. The utility has the opportunity to respond through the filing of additional written testimony of its own.

In many cases, prior to the hearing on the application, the Commission holds public comment sessions in the service territory of the utility. These meetings are intended to allow customers to express their opinions about the rate request and to provide the Commission with information that the customers feel is relevant to the case. It is not required, nor is it expected, that customers making comments at these meetings be represented by counsel.

The Commission then holds a formal hearing on applications which require hearings. At the hearing, the utility, the Commission Staff, RUCO, and other intervenors present witnesses, offer evidence, and conduct cross-examination of other parties' witnesses on the issues raised in the filed reports and testimony. Issues commonly disputed in rate cases include: which expenses should be charged in rates to ratepayers; what a normal or prudent level of expenses should be; whether all of the utility's investments in physical facilities were prudently made and whether the facilities are needed for the provision of utility services; how much of a return the utility's shareholders should be allowed to earn on their investment; and how the cost of providing service should be allocated to, and recovered from, the utility's various classes of customers.

After the hearing is concluded, the Commission's Administrative Law Judge reviews the evidence and the parties' arguments and issues a Recommended Order. The Recommended Order sets forth a recommended decision on all contested issues and recommends how much of a rate increase, if any, the utility should receive. The parties are permitted to file exceptions to the Recommended Order, asking the Commission to disregard the conclusions of the Recommended Order and suggesting an alternate resolution. At a public meeting, the Commission considers the Recommended Order, and the parties' exceptions to it. The Commission can adopt or deny the Recommended Order as originally written, incorporate any of the suggested exceptions, or make its own amendments.

After the Commission issues its final decision, the parties have twenty days to request the Commission to reconsider its decision. If the Commission declines to grant a rehearing, the parties may appeal the decision to the Arizona Court of Appeals. Decisions of the Court of Appeals may be appealed to the Arizona Supreme Court. Filing an appeal does not prevent the rates approved by the Commission from taking effect.

RUCO'S BUDGET

RUCO receives no money from the general tax fund. Rather, RUCO receives 100 percent of its operating budget from assessments of large utility companies that may, in turn, pass those charges on to their residential customers. In this way, those who benefit from RUCO's work fund its work. The utility ratepayers who pay these small assessments should consider their money well spent. The following reflects FY 2003 activity for the appropriation year 2003, excluding the professional witness budget and the approved amount for same in FY 2004.

EXPENDITURE CATEGORIES	ACTUAL 2003	APPROVED 2004
PERSONAL SERVICES	\$664,500	\$664,500
EMPLOYEE EXPENSES	\$132,700	\$162,800
ALL OTHER	\$304,200	\$318,400
TOTAL	\$1,101,400	\$1,145,700

RUCO'S FUNDING MECHANISM

Pursuant to A.R.S. § 40-401.01, funding of RUCO is accomplished through an assessment made annually by the Commission. Each utility with annual residential revenues in excess of \$250,000, except those not required to hold Certificates of Convenience and Necessity, is assessed.

The disposition of assessment proceeds is governed by A.R.S. § 40-409. All monies received by the Commission under the provisions of A.R.S. § 40-401.01 are paid to the State Treasurer and placed in the RUCO Revolving Fund. Monies in the fund are used, subject to legislative appropriation, to operate RUCO pursuant to A.R.S. § 40-461. Appropriated funds not spent by the end of a fiscal year do not revert to the General Fund. They revert to the RUCO Revolving Fund and are used to calculate the ratepayer assessment for the next fiscal year. Based on the information available at the end of FY 2003, the assessment for FY 2004 was \$1,145,700.

RUCO'S CASE ANALYSES AND INTERVENTIONS

As previously described, RUCO generally seeks to avoid intervening formally in small rate cases. Nevertheless, these cases are analyzed for potential cost impacts on ratepayers. Generally, rate applications for small utilities do not warrant formal RUCO intervention, which could unnecessarily increase costs to small utility ratepayers. The following table illustrates how RUCO's intervention activity over the past fiscal year compares to prior years:

	1999	2000	2001	2002	2003
NUMBER OF CASES ANALYZED	102	100	102	115	92
NUMBER OF RUCO INTERVENTIONS	34	13	11	14	13

RUCO'S IMPACT

The following table illustrates RUCO's impact on rate requests by utilities over the past fiscal year, compared to prior years:

	1999	2000	2001	2002	2003
AVERAGE UTILITY RATE REQUEST (MILLIONS \$)	.3	5.1	33.9	8	10.7
AVERAGE RUCO RECOMMENDATION	.1	.8	5.9	1.8	7.8
AVERAGE ACC APPROVED RATE	.2	3.1	4.1	3.0	7.7

CONSUMER EDUCATION AND OUTREACH ACTIVITIES

Beginning in January 2003, RUCO upgraded its website to make it more user-friendly, interactive and content-rich. In response to the Legislature's original zero-based budget for the Office for Fiscal Year 2004, RUCO developed a database of information about supportive constituents including regular postal and email contact addresses. RUCO then created and distributed primarily via email a toolkit of advocacy tools to inform the public and legislators about RUCO and its mission. This proved a very efficient and cost-effective means to inform the general public, the media and policy-makers about the Office, and ultimately figured prominently in the Office receiving its needed expenditure authority from the Legislature.

Beginning in July 2003, RUCO initiated the publication and distribution of a bi-monthly consumer-oriented electronic newsletter, *The RUCO Watchdog*, sent to the newly-developed database of email addresses. As of October 2003, the list of recipients has grown from approximately 180 to over 400 recipients, and fewer than one-half of one percent of the addressees have requested to unsubscribe from the newsletter list. *The Watchdog* is published in both HTML and text formats to accommodate individual preference. The successful launch of *The Watchdog* earned favorable press coverage for the Office.

RUCO maintains a speakers bureau and responds to groups requesting presentations about the Office and matters affecting communities pending before the Corporation Commission. Additionally, RUCO staff attend all Corporation Commission public comment sessions where Commissioners are expected to be in attendance, irrespective of where in the state those sessions are held. Since January 2003, Office personnel have traveled to Mohave, La Paz, Gila, Santa Cruz, Pima and Yavapai counties to attend ACC public comment sessions and to meet with local consumers. Beginning in Fall 2003, RUCO will develop case-specific informational pamphlets and, where appropriate, CD-ROMs for distribution to communities concerned about particular rate cases affecting them.

RUCO plans to continue to build on its capacity to utilize available software- and internet-based tools to reach a greater public, delivering useful information in a respectful and unobtrusive manner, at little or no incremental cost to those that ultimately fund RUCO—the ratepayers of Arizona.

CASE SUMMARIES

(Click [here](#) to review a list of acronyms and terms commonly used throughout the descriptions in these Case Summaries).

ON-GOING CASES

(those not closed by June 30, 2003, listed in order of Docket-opening date).

Electric Industry Restructuring – Docket Nos. RE-00000C-94-0165 and E-00000A-02-0051.

In May 1994, the Commission's Utilities Division Staff ("Staff") opened Docket No. RE-00000C-94-0165, to study electric industry restructuring for the State of Arizona. After public input, the Commission adopted new rules A.A.C. R14-2-1601 through R14-2-1616 ("Competition Rules") in December 1996 in Decision No. 59943.

In August 1998, the Commission adopted amendments to the Competition Rules on an emergency basis. Included in those amendments were requirements that incumbent utilities divest their generation resources to an affiliate or a third party, and that incumbent utilities acquire power for standard offer customers through competitive bids. In December 1998, the Commission adopted permanent amendments. In January 1999, the Commission suspended the Competition Rules pending further consideration. After taking additional comment on the Rules, the Commission adopted revised Competition Rules in September 1999.

Beginning in December 1998, the Commission issued CC&Ns to a number of competitive Electric Service Providers. Several of the incumbent utilities appealed the decisions granting CC&Ns to the Superior Court. In November 2000, Judge Campbell issued judgment to vacate the Competition Rules and CC&N decisions. A number of parties, including RUCO, appealed Judge Campbell's decision to the Court of Appeals. The Court heard oral argument on the appeal in February 2002. No decision has been issued to date.

In October 2001, Arizona Public Service Company filed an application for a partial variance from the Commission's rule requiring competitive procurement of power for standard offer customers, and for approval of a purchase power agreement with APS' affiliate to which it was planning to transfer its generation assets. APS' application was based on its perception that western wholesale electricity markets were unstable and that competitive acquisition of power in that market was imprudent.

In January and February 2002, each of the three Commissioners issued letters seeking information pertaining to the restructuring of Arizona's electric industry. The Commission opened a new docket (E-00000A-02-0051) to examine electric restructuring issues. Interested parties provided responses to the Commissioners' questions, and in March 2002 Staff issued a report and recommended that certain issues be addressed in the new docket.

Prior to considering APS' application for a partial variance and approval of a purchase power agreement, the Commission ordered that certain threshold issues (primarily wholesale market power and the transfer of generation assets by the incumbent utilities) be considered in what became known as Track A of the new generic docket. In addition, the Commission instructed that competitive solicitation issues be considered in a second Track B. A hearing on Track A issues was held in June 2002. In September 2002, the Commission adopted an order resolving

the Track A issues. That order found that APS and Tucson Electric Power Company ("TEP") have market power in certain areas; that the wholesale electricity market applicable to Arizona is poorly structured and susceptible to possible malfunction and manipulation. The order concluded that the requirement that incumbent utilities transfer their generation assets to others is not in the public interest at this time, and suspended that rule. The Order further required APS and TEP to file necessary modifications to their codes of conduct, and required that a review of the Competition Rules be undertaken.

Track B issues were initially addressed in workshops. A hearing on unresolved Track B issues was held in November 2002, and the Commission issued its order in March 2003. APS and TEP solicited power from the wholesale market pursuant to the requirements of the Track B order. As a result, APS executed three contracts and TEP executed two contracts with alternative wholesale suppliers.

Pursuant to the requirements of the Track B order, the Commission will be holding environmental risk management workshops to develop criteria to weigh the environmental impact of offers received in future solicitations, and to discuss the costs and benefits of environmental mitigation. In addition, the Commission will hold workshops to address demand-side management ("DSM") issues, including the development of a process by which DSM resources can be acquired in future solicitations.

US West Communications, Inc.'s (now Qwest Corporation) Compliance with Section 271 of the Telecommunications Act of 1996 - Docket No. T-00000A-97-0238.

In 1996, the Congress enacted the Telecommunications Act of 1996 ("Act"), which detailed the requirements for incumbent local exchange carriers (ILECs) to offer in-region interLATA services. Qwest, as the largest ILEC in the state of Arizona, must satisfy the Federal Communications Commission (FCC) that it meets a 14 point competitive checklist to demonstrate that it has effectively opened its local market to competitors (Competitive Local Exchange Carriers, or CLECs), and must prove that giving the Company the ability to provide in-region interLATA service would serve the public interest.

Additionally, the Act required the FCC to consult with the relevant state commission(s) on the checklist issues. The Arizona Corporation Commission's role is to make a recommendation to the FCC as to whether Qwest has met the requirements of the Act.

Qwest filed its application for permission to enter the long distance telecommunications market (known as a Section 271 filing of the Act) with the Arizona Corporation Commission in 1998. Qwest supplemented its filing at the Commission's request in March 1999. By subsequent procedural orders, the Commission determined to divide the issues into a number of categories (Operational Support Systems (OSS), Non-OSS, Performance Assurance and Public Interest), and to proceed by collaborative workshops to attempt to obtain a mutually acceptable result for all parties.

The Commission's process also included consideration of the individual checklist items required by the Act. On March 8, 2002, AT&T filed a motion with the Commission to reopen the record in portions to determine whether Qwest was actually compliant with 271 given its actions in not filing certain agreements with the Commission under Section 252(e) of the 1996 Act (see 252 report). The Commission's Staff opened a separate docket on April 8, 2002 to consider the 252 issues. The parties questioned whether or not to proceed with the 271 matter prior to concluding the 252 matter. The issue was submitted to the Hearing Officer for a determination.

On December 23, 2002, the Hearing Officer issued her Procedural Order deferring a determination of whether the 252 proceeding needed to conclude prior to the Commission making a final recommendation on the Public Interest portion of the 271 docket.

On September 5, 2003 Staff filed its Supplemental Final Report on 271 and recommended that the Commission approve Qwest's application for 271 approval as it relates to the public interest. RUCO filed its comments opposing approval until the Commission resolved the 252 issue.

The matter was heard at Open Meeting held on September 19, 2003 and by a vote of 3-2, the Commission approved Qwest's application for 271 approval. The Commission has sent notice of its approval to the Federal Communications Commission. The FCC will ultimately decide whether to grant Qwest 271 approval, allowing it to provide long distance service in Arizona.

Arizona Water Company – Application Requesting an Arsenic Cost Recovery Mechanism (ACRM) - Docket No. W-01445A-00-0962.

This case was originally filed on November 22, 2000 as part of the Arizona Water Company's ("AWC" or "Company") permanent rate application for its Northern Group, in addition to a rate consolidation issue. At the request of the Company, the arsenic cost recovery mechanism (ACRM) issue was bifurcated from the original application as a separate issue on August 29, 2001. All parties agreed to alter the procedural order and establish a separate phase for the arsenic issue.

AWC sought approval to establish an accounting mechanism to track capital costs and operating expenses related to arsenic treatment and removal to be recovered by the Company upon filing of a notice letter rather than a rate case. The Company's request arose from rules established by the United States Environmental Protection Agency ("EPA") that required maximum contaminant levels ("MCL") for arsenic in potable water to be reduced from 50 parts per billion ("ppb") to 10 ppb, effective January 2006.

In Decision No. 64282 (December 28, 2001), the Commission approved a rate increase for AWC's Northern Group of approximately 16 percent. In that Decision, the Commission affirmed the need for a second phase ("Phase II") to address arsenic treatment cost recovery and ordered this docket to remain open for an additional 180 days to allow the Company, Commission Staff, and RUCO to develop a proposed procedure for the recovery of such costs. In addition, the Commission stated that it would "consider Arizona Water's rate consolidation proposal in the context of the parties' ongoing discussions regarding recovery of arsenic MCL capital costs" (Decision No. 64282, at 21).

AWC, RUCO, and Staff continued discussions on the Phase II issues (arsenic treatment cost recovery and rate consolidation) and filed a Final Joint Report on May 30, 2002. At the parties' request, a Procedural Conference was conducted on July 16, 2002. On July 23, 2002, a Procedural Order was issued establishing deadlines for filing testimony, publication of notice, and setting a hearing for October 3, 2002 to address issues that remained unresolved from the parties' negotiations. The Phase II hearing was conducted on October 3 and 18, 2002.

RUCO recognized these estimated arsenic compliance costs represented an enormous financial burden facing AWC and recommended a two-step process for the Company to recover its capital costs. These capital costs would be recovered through a separately identified surcharge on customer bills and would be permitted for arsenic facilities placed in service

between 2003 and 2006. As for the O&M expenses, RUCO opposed the inclusion of any O&M related costs. RUCO also disagreed with the consolidation issue because it would promote cross-subsidization between systems that are not physically inter-connected. Staff and RUCO proposed the ACRM approval be conditioned on a requirement that AWC file a general rate application no later than September 30, 2007, based on a 2006 test year.

A Recommended Opinion and Order (RO&O) was issued on April 8, 2003, which agreed with RUCO on virtually all points including consolidation, O&M costs and the two-step process. The RO&O was discussed at the Commission's April 22, 2003 Open Meeting. Through exceptions, the Company introduced the possibility of leasing the equipment along with leasing arrangements that provided for operational and maintenance expenses for the said equipment rather than the Company constructing and operating company-owned plant. Since the leasing option was never discussed during the hearing, the Commission ordered all the parties back into negotiations regarding the leasing option.

The parties were unable to reach agreement through negotiation and a second hearing was held on June 26, 2003. A revised RO&O was issued on August 25, 2003, which would allow ACRM treatment for leased arsenic facilities. It also recommended the inclusion of certain O&M costs as well as approved consolidated rates, contrary to the original order. The revised RO&O went to Commission vote on September 18, 2003. The RO&O was approved as amended by the Commissioners to deny the rate consolidation.

US West Communications, Inc.'s (now Qwest Corporation) Compliance with Section 252 of the Telecommunications Act of 1996 - Docket No. RT-00000F-02-0271.

In 1996, the Congress enacted the Telecommunications Act of 1996, which detailed the requirements for incumbent local exchange carriers (ILECs) to offer in-region interLATA services. Section 252 of the Act provides, among other things, that any interconnection Agreements shall be submitted for approval to state Public Utility Commissions. One purpose of the Act was to protect competition and competitors from discriminatory behavior. Section 252 facilitates the Act by requiring the filing of interconnection agreements in order that competitive local exchange carriers (CLECs) can opt-in and be afforded the same opportunities as its competitors

On March 8, 2002, AT&T filed a motion with the Commission to reopen the 271 filing (the Company's request to enter into the long distance market) in portions to determine whether Qwest was actually compliant with 271 given its actions in not filing certain agreements with the Commission under Section 252(e) of the 1996 Act (see 252 report). The Commission's Staff opened a separate docket on April 8, 2002 to consider the 252 issues. RUCO intervened in the 252 docket and undertook a very aggressive investigation. RUCO determined that reasonable grounds existed to believe that Qwest entered into a scheme with McLeodUSA and Eschelon to discriminate against other competitors and against competition in general. RUCO requested additional time to allow it to audit the three companies in an effort to determine exactly the full extent of the scheme. A procedural conference was held on September 19, 2002 to determine the procedure that the Commission will follow in considering the issues.

On November 7, 2002, the Administrative Law Judge issued her Procedural Order setting forth due dates for the filing of testimony and scheduling a hearing. The hearing took place from March 17-20 2003. Post-Hearing Briefs were filed. On July 25, 2003, prior to the issuance of a Recommended Opinion and Order, Staff and Qwest filed a Notice that they had reached a Settlement Agreement resolving the outstanding issues in three dockets (including the 252

docket) and requesting a procedural conference. The Settlement Agreement provided for, among other things, approximately \$22 million in payments by Qwest through a variety of measures designed to remedy the harm caused by Qwest's improper conduct.

RUCO considered the Settlement Agreement but believed that it does not go far enough to remedy the demonstrated harm. RUCO believes that Qwest needs to be held accountable either by an explicit legal finding on the record by the Commission that Qwest engaged in unlawful conduct or that Qwest admit to its improprieties. Other intervenors also opposed the Settlement Agreement and the matter was scheduled for hearing. The hearing was held on September 16 and 17, 2003, and Post-Hearing Briefs are due to be filed in October, 2003.

Arizona Public Service Company – Request for Rate Adjustor Mechanisms - Docket No. E-01345A-02-0403.

On May 31, 2002 the Arizona Public Service Company (APS) filed a request for approval of several rate adjustment mechanisms. The request was filed pursuant to the 1999 APS settlement agreement (Decision No. 61973) that provided that "the Commission shall approve, by December 31, 2002, an adjustment clause or clauses which will provide full and timely recovery beginning July 1, 2004 of the reasonable and prudent costs." APS's request included the following four adjustor mechanisms:

- 1) Purchase power and fuel adjustor;
- 2) Large customer power supply adjustor;
- 3) Transition cost recovery mechanism; and
- 4) System benefits adjustor.

RUCO filed testimony in this docket on February 13, 2003, opposing the approval of the purchase power and fuel adjustor mechanisms. RUCO argued that since the stay of generation asset divestiture in Decision No. 65154, the mechanism was no longer warranted and did not meet the definition for automatic adjustment as defined by the commission and the courts.

A hearing on this matter commenced on April 7, 2003. A Recommended Opinion and Order is pending.

Southwest Gas Corporation – Application for Approval of Acquisition Plan and waiver of Selected Provisions of the Affiliate Rules – Docket No. G-01551A-02-0425.

On June 6, 2002, Southwest Gas Corporation ("Southwest" or "SWG") filed an application for approval of an Acquisition Plan and, if appropriate, waiver of selected provision of the affiliate rules.

Southwest applied for approval of an acquisition of the shares, the subsequent transfer of Black Mountain Gas Company ("Black Mountain" or "BMG") assets to Southwest and the dissolution of Black Mountain. Under the terms of the Acquisition Plan, Southwest would succeed to the ownership of Black Mountain. BMG provides natural gas and propane service within the State of Arizona as a public service corporation. Xcel Energy Inc. ("Xcel"), a Minnesota corporation, owns one hundred percent of the outstanding shares of stock in Black Mountain. Southwest and Xcel have executed a stock purchase agreement, by which SWG had agreed to purchase and Xcel had agreed to sell these shares. Southwest intended to own the shares for a limited period of time prior to having all of the assets of Black Mountain transferred to SWG and dissolving BMG.

On November 27, 2002, a settlement discussion was held at which time Staff proposed a settlement agreement.

On December 4, 2002, Southwest offered a counterproposal.

On December 5, 2002, ACC Legal Division issued a letter, which stated Staff finds SWG's counterproposal unacceptable; and Staff is to proceed with the current procedural order.

On December 20, 2002, Staff and RUCO filed testimony.

On February 6, 2003, SWG and BMG filed rebuttal testimony.

On February 19, 2003, a pre-hearing conference was held. The ALJ determined the hearing would take place on February 24, 2003 and followed up on March 3, 2003 to facilitate Staff testimony due to a scheduling conflict.

On July 8, 2003, the Administrative Law Judge issued a Recommended Opinion and Order ("RO&O"). The Commission approved the RO&O as filed in Decision No. 66101, dated July 25, 2003.

The Order provides for the following:

1. Approval of the Acquisition Plan.
2. Authorization to transfer assets and CC&N of BMG to SWG.
3. SWG shall dissolve BMG before July 1, 2004.
4. BMG's rates and charges to remain in effect until June 30, 2004 and then SWG's rates and charges shall be implemented, without any consideration of a rate case.
5. The Commission will defer consideration of the acquisition adjustment until the next rate case.

RUCO opposed the provision in the Order that would allow implementation of SWG's rates and charges in BMG's service territory without allowing a complete analysis of all of the following: expenses, income, rate base, cost of capital, required revenue etc. If this provision were to set policy in future regulatory proceedings, biased and unfair rates could result. Absent this provision, RUCO supported the acquisition of BMG by SWG and believes the transaction is in the public interest.

Arizona Water Company – Application Requesting Adjustments of Rates and Charges for the Company's Eastern Group and for Certain Related Approvals – Docket No. W-01445-02-0619.

On August 14, 2002, the Arizona Water Company ("Arizona Water" or "Company") filed an application for a permanent rate increase for its Eastern Group, which includes a total of eight separate operating systems located in Apache Junction, Bisbee, Miami, Oracle, San Manuel, Sierra Vista, Superior and Winkelman.

Based on the Company-selected historical test year ended December 31, 2001, Arizona Water's proposed rates will produce an increase in Eastern Group operating revenues of \$4,256,510 or 29.05 percent over Company-adjusted test year revenues of \$14,653,117. The Company is seeking a rate of return of 11.00 percent on a Company-proposed Eastern Group rate base of \$41,604,880 (during the rejoinder phase of the proceeding, the company revised its figures to reflect a 24.86 percent increase and a 10.90 percent required rate of return).

Among the various issues associated with the Company's filing were the inclusion of mismatched post-test year plant additions in rate base, the recovery of deferred Central Arizona Project charges for the Eastern Group's Apache Junction system, a request for rate consolidation (that involved the Apache Junction and Superior systems) in order to mitigate the actual increase in rates required to provide service to the Superior system as a result of increased arsenic removal costs, and a Company proposed cost of equity capital of 12.40 percent. Both the size of the Company and the various issues presented in the Company's application warranted immediate intervention by RUCO staff.

RUCO's Chief Legal Counsel filed a motion to intervene with the ACC on September 16, 2002. Subsequently, RUCO was granted intervention by the ACC's Hearing Division on September 27, 2002.

RUCO staff performed a full audit of Arizona Water Company's Eastern Group operating systems and conducted a complete cost of capital analysis. In addition, RUCO staff members assigned to the case also participated in an on-site inspection of the post-test year plant additions that the Company sought to include in rate base.

Based on the results of its audit of the Eastern Group systems, RUCO is recommending an increase in Eastern Group operating revenues of \$679,724 or 4.34 percent over RUCO's adjusted test year revenues of \$15,655,569. Based on the results of its cost of capital analysis, which produced a 9.18 percent cost of equity capital, RUCO is recommending an 8.68 percent rate of return (the weighted cost of both debt and equity) on the Company's invested capital in the Eastern Group.

Because of the timing of this particular case, and the Commission's allowance for a 105-day extension in the proceeding, RUCO was able to match all of the Company's post-test year operating figures with the post-test year plant additions that were requested by the Company. This solved a matching problem that occurs when the Commission allows the inclusion of post-test year plant additions into rate base without taking into consideration all of the other post-test year ratemaking elements (i.e. additions financed by advances and contributions in aid of construction, increased accumulated deferred income taxes and actual, as opposed to estimated, levels of operating expense). In previous proceedings before the Commission, RUCO has consistently argued that mismatches that occur by only allowing the inclusion of Company-financed post-test plant additions to rate base, as in this case, results in higher utility rates to customers and the potential for over-earning on invested capital by utilities and their shareholders.

An evidentiary hearing on the matter was held at the Commission's offices in Phoenix during the entire week of September 22, 2003. During the hearing, RUCO witnesses faced a total of four-and-one-half hours of cross-examination by the Company's attorneys.

RUCO witnesses argued that the Commission should adopt RUCO's recommended rate base and operating expense levels which perfectly matched all of the Company's ratemaking

elements noted above. A comparison of the proposed increases in revenue by the Company, ACC Staff and RUCO are as follows:

<u>EASTERN GROUP SYSTEM</u>	<u>(A) COMPANY REQUESTED</u>	<u>(B) ACC STAFF RECOMMENDED</u>	<u>(C) RUCO RECOMMENDED</u>
APACHE JUNCTION SYSTEM	8.80%	-9.24%	-6.36%
BISBEE SYSTEM	51.12%	30.09%	24.97%
MIAMI SYSTEM	44.62%	14.24%	16.58%
ORACLE SYSTEM	26.97%	10.52%	-2.01%
SAN MANUEL SYSTEM	90.87%	74.83%	65.89%
SIERRA VISTA SYSTEM	44.15%	24.84%	8.76%
SUPERIOR SYSTEM	68.46%	47.76%	39.64%
WINKELMAN SYSTEM	34.86%	18.42%	20.68%

The evidence presented in the case is now being weighed by an administrative law judge, who will write a proposed order on the Company's request for an increase in rates. ACC Commissioners will vote on the proposed order at an upcoming open meeting at the ACC's Phoenix office. A final decision on the matter is expected before the end of December 2003.

Sale of Qwest Dex assets - Docket No. T-015051B-02-0666.

On August 30, 2002, Qwest filed with the Commission a notice of the sale of the directory publishing assets in Arizona ("Notice") owned by Qwest to a third party, non-affiliated buyer ("Buyer"). In its Notice, Qwest requested that the Commission declare that the sale falls within the waiver granted in ACC Decision No. 58087 or that the sale is not subject to the Commission's regulatory authority based on the May 27, 1988 Settlement Agreement ("1988 Settlement Agreement") between the Commission and Mountain States Telephone and Telegraph Company (Qwest's predecessor).

The sale provided in relevant part for a \$7.05 billion purchase price. Under the terms of sale, the Buyer would publish directories for 50 years. Another condition of the sale was Qwest's agreement to not attempt to develop its own directory publishing or compete with the Buyer in the directory market for 40 years.

RUCO opposed the sale as originally proposed because RUCO felt it did not provide adequate safeguards and assurances. Testimony was filed and the matter was scheduled for hearing. On March 28, 2003, prior to the hearing, Staff filed notice that it had reached an agreement in principle with Qwest. The Agreement provided for an annual imputation of directory revenue of \$72 million for a duration of 15 years.

Thereafter, the Commission issued a Procedural Order scheduling testimony and a hearing date. The hearing was held on May 16, 27, and 28, 2003. RUCO opposed the Settlement

Agreement. RUCO recommended that the Commission approve the sale but increase the imputation period from 15 to 40 years.

On September 8, 2003 the Hearing Officer issued her Recommended Opinion and Order approving the Settlement Agreement as proposed. The matter was heard at Open Meeting on September 5, 2003. By a vote of 5-0, the Commission approved the Settlement Agreement as modified to include RUCO's recommendation of lengthening the imputation period from 15 to 40 years. The present value of future consumer savings from adoption of RUCO's suggested modifications to the Agreement is approximately \$227 million.

Arizona-American Water Company, Inc. – Application For Increases In Rates And Charges For Water And Wastewater Services In Ten Of Its Districts – Multiple Dockets.

On November 22, and December 13, 2002, Arizona-American Water Company, Inc. ("Arizona-American", "AZ-AM" or "Company") filed an application for a determination of the current fair value of its utility plant and property and for increases in its rates and charges based thereon for utility service in selected water and wastewater districts.

This consolidated proceeding requests increases in the rates and charges for ten systems ("Districts") under the ownership umbrella of Arizona-American. The rate cases for these ten Districts were filed in five separate applications:

1. First Application:
Sun City West Water..... Docket No.: W-01303A-02-0867
Sun City West Wastewater..... Docket No.: SW-01303A-02-0867
2. Second Application:
Sun City Water..... Docket No.: W-01303A-02-0868
Sun City Wastewater..... Docket No.: SW-01303A-02-0868
3. Third Application:
Mohave Water..... Docket No.: W-01303A-02-0869
Havasu Water..... Docket No.: W-01303A-02-0869
4. Fourth Application:
Agua Fria Water..... Docket No.: W-01303A-02-0870
Anthem Water..... Docket No.: W-01303A-02-0870
Anthem/Agua Fria Wastewater.... Docket No.: SW-01303A-02-0870
5. Fifth Application:
Tubac Water..... Docket No.: W-01303A-02-0908

These ten Districts were previously owned by Citizens' Communications ("Citizens" or "CUC"). Arizona-American purchased all of the water and wastewater assets of Citizens in Arizona as approved by the Commission in Decision No. 63584, dated April 24, 2001, with AZ-AM assuming operational control on January 15, 2002.

On March 3, 2003, the Administrative Law Judge ("ALJ") issued a procedural order. However, On June 2, 2003 all parties agreed to an extension of time and stipulated to file testimony on September 5, 2003, with the hearing to commence on December 4, 2003.

On September 5, 2003, Staff and RUCO filed direct testimony.

The Company had requested increases ranging from 6.80% to 86.74%. RUCO's testimony recommended rate decreases for 4 out of the 10 systems ranging from -17.98% to 31.70%. RUCO's testimony clearly showed the rate increases proposed by the Company were unwarranted.

Some of the issues that will have to be considered by the ALJ before he files his Recommended Opinion and Order ("RO&O"):

1. To determine the fair value rate base. The Company requests the value of gross plant to be determined by the reconstructed costs new less depreciation; Staff and RUCO recommend the original costs should be the valid determinants of the plant value.
2. To allow an acquisition adjustment. The Company requests recovery of the \$71.6 million paid to Citizens Utilities for these districts in excess of its net book value of the properties purchased. Staff and RUCO recommend any consideration of the acquisition adjustment be postponed until next rate case.
3. To adjust test year expenses to reflect present conditions. Since AZ-AM did not operate these districts during the 2001 test year, the Company estimated many of its operating and administration costs for this application. Staff and RUCO recommend several adjustments based on actual records.

A hearing is scheduled on this matter for December 4, 2003.

Arizona Public Service Company – Request for an increase in rates - Docket No. E-01345A-03-0437.

On June 30, 2003 Arizona Public Service Company (APS) filed for an increase in rates of 9.77%. APS provides service to approximately 900,000 customers in the Phoenix metropolitan area. If approved this would be the APS's first rate increase in over 10 years.

RUCO was granted intervention in this docket on August 15, 2003. RUCO in-house personnel, as well as several consultants retained by RUCO, are in the process of issuing discovery, identifying and analyzing issues in this case. RUCO will file its direct testimony on January 9, 2004 and a hearing is scheduled in this matter for April 7, 2004.

CASES CLOSED IN FY 2003
(listed in order of closing date)

Bella Vista Water Company - Application for an Increase in Rates – Docket No. W-02465A-01-0776.

On September 28, 2001, Bella Vista Water Company, Inc. ("Bella Vista" or "Company") filed an application seeking a permanent rate increase. The Company provides water utility service to residential and commercial customers located in and around the City of Sierra Vista, which is located on State Highway 90, approximately seventy miles southeast of Tucson, in Cochise

County. During the test year ended December 31, 2000, Bella Vista provided water service to an average of 6,659 customers of which approximately 5,876, or 88.2 percent, were residential customers.

Bella Vista's original application requested a total increase of \$594,433 or 20.44 percent more than the Company's adjusted test year operating revenues of \$2,907,775. After analyzing Bella Vista's application in October 2001, RUCO decided that the case warranted intervention. RUCO filed its motion for intervention on November 9, 2001, and on November 29, 2001, the Commission's Hearing Division granted RUCO's request.

On April 29, 2002, RUCO filed direct testimony recommending a revenue increase of no more than \$19,333 or a 0.66 percent increase over RUCO's adjusted test year operating revenues of \$2,908,066 (RUCO's recommended operating revenue figure included a \$21,030 decrease in water sales revenue). More importantly, RUCO recommended that the Commission exclude approximately \$1.8 million in post-test year plant additions that Bella Vista had included in the Company-proposed rate base. RUCO has consistently taken the position that the inclusion of post-test year plant is a violation of the historical test year concept that Arizona adheres to, and creates a mismatch between test year operating expenses and actual plant that provided service to ratepayers during the test year (a position that Commission Staff also took in this case). In addition, RUCO recommended cuts in Bella Vista's Board of Directors fees, which RUCO believed were excessive, and took issue with the Company's rate design, which imposed a three-tier commodity rate on the Company's smaller meter customers as opposed to a two-tier rate for larger meter customers. Prior to hearing, RUCO took part in settlement discussions with the Company and Commission Staff, but the parties were unable to come to a final agreement.

The evidentiary hearing for Bella Vista was held at the Commission's Tucson offices on July 25 and 26, 2002. During the hearing, RUCO witnesses faced approximately four hours of cross-examination by the Company's attorney.

On November 1, 2002, the ACC issued Decision No. 65350, which granted Bella Vista a revenue increase of \$3,145,612 or an 8.18 percent increase over the Company adjusted test year revenue figure of \$2,907,775. Despite both ACC Staff's and RUCO's arguments against the inclusion of mismatched post-test year plant additions, the Commission approved the Company's request to include \$1.8 million in post-test year plant additions in the Company's rate base and the Company's proposed rate design.

Litchfield Park Service Company – Application Requesting a Permanent Increase in Water and Wastewater Rates – Docket Nos. W-01427A-01-0487 and WS-01428A-01-0487.

This case was initially filed on June 15, 2001. Before the scheduled hearing, Litchfield Park Service Company ("LPSCO" or "Company"), Staff, and RUCO reached a Settlement Agreement. The City of Litchfield ("City") opposed the settlement. The hearing was held as scheduled on April 3, 2002, at which time the Commission's Administrative Law Judge heard testimony on the settlement. In June 2002, the Commission declined to approve the Settlement Agreement and instructed its Hearing Division to take additional testimony relating to the City's objections.

The City alleged: 1) that the Company used unfair and biased construction cost practices to third party developers within its service territory, 2) there is potential for abuse since LPSCO is owned by a major home developer (SunCor) of master planned communities in the Utilities' service area, 3) that excess capacity existed on LPSCO's water distribution system, and 4) that

there is not a proper balance between Advances-in-Aid-of-Construction (AIAC), Contributions-in-Aid-of-Construction (CIAC), debt, and equity financing.

A hearing was held on the City's objections beginning September 4, 2002. While RUCO had originally shared some of the City's concerns, RUCO testified that it had examined the City's claims when it first performed its financial analysis and audit. RUCO concluded at that time the Company had no excess capacity, that there was a proper balance between AIAC, CIAC, debt and equity financing, and LPSCO had not abused its related party association with SunCor.

Commission Decision No. 65436, dated December 10, 2002, ordered that the Settlement Agreement filed on April 1, 2002 by LPSCO, Staff, RUCO, and PebbleCreek Properties Limited Partnership was reasonable and in the public interest. The agreement was adopted in its original format, subject to the modification of the depreciation rate, which went into effect January 1, 2003.

LPSCO's General Manager and Company Attorney, Mr. Dave Ellis and Mr. Richard Sallquist respectively, visited RUCO's Office early 2003. At that meeting, Mr. Ellis informed RUCO of LPSCO's new ownership. An independent group not affiliated with SunCor now owns the Company rendering any future concerns regarding affiliated interests moot.

Arizona Public Service Company Financing Application – Docket No. E-0134502-0707.

Pursuant to APS's stranded costs settlement and the Electric Competition Rules, APS was required to divest its generation assets to an affiliate by January 1, 2003. Subsequent to the approval of the settlement, new generation was constructed within APS's sister company Pinnacle West Energy Corporation ("PWEC"), the same entity to which APS intended to transfer its generation assets. The new plant was financed by bridge debt issued by the parent company Pinnacle West Capital Corporation ("PWCC"). PWEC intended to refinance the bridge debt after the transfer of the generation assets from APS.

In Decision No. 65154 (September 10, 2002), the Commission recognized that competition had not developed as expected in the wholesale electric market, and therefore instructed APS to cancel plans to divest its generation assets to PWEC and stayed the requirement that APS obtain power for standard offer customers from the competitive market.

APS's application sought authority to issue \$500 million of long-term debt, the proceeds of which it would loan to its affiliate PWEC or APS's parent PWCC to support the long-term financing of PWEC's generation assets. In the alternative, APS requested authority to guarantee PWEC's or PWCC's issuance of \$500 million of long-term debt to support the PWEC generation assets.

RUCO supported the application but proposed that APS be required to file an application within 45 days to transfer the PWEC generation assets to APS. With appropriate conditions, the financing would allow APS/PWEC to maintain the generation assets to the benefit of APS customers. RUCO recognized that granting the application was a stopgap measure to prevent PWCC from defaulting on its short-term debt obligations and going into bankruptcy, but that a cohesive plan to rebuild the regulatory paradigm was necessary to return the electric industry in Arizona to functional viability.

The Commission approved APS's application on April 4, 2003 with several conditions. The Commission did not adopt RUCO's recommendation to require APS to file an application to

transfer the PWE generation assets to APS. However, prior to the hearing, Commission Staff negotiated a possible resolution with APS to APS's appeal of Decision No. 65154. One of the elements in the principles for resolution was an agreement to permit APS to propose, in its forthcoming rate case, to include the PWE generation assets in APS's rate base.

Green Valley Water Company – Application for an Increase in Rates – Docket No. W-02025A-01-0559.

On July 12, 2001, Green Valley Water Company ("Green Valley" or "Company") filed an application requesting a permanent increase in the Company's water rates. Green Valley provides water utility service to residential and commercial customers in the community of Green Valley, which is located on Interstate 19, approximately 10 miles south of Tucson, in Pima County. During the test year ended December 31, 2000, Green Valley provided water service to approximately 3,650 customers, of which 3,400 or 93.2 percent are residential customers.

In its application, Green Valley requested a total increase of \$364,165 or 36.8 percent more than the Company's adjusted test year operating revenues of \$989,568.

RUCO's in-house staff analyzed Green Valley's application in August 2001 and concluded that intervention in the proceeding was warranted. RUCO filed a motion for intervention on August 27, 2001, and was granted intervenor status on September 17, 2001.

On February 11, 2002, after completing a thorough audit of the Company and conducting a full cost of capital analysis, RUCO filed direct testimony recommending that the Company's level of revenue be increased by \$180,974 or approximately half the amount of increase sought by Green Valley.

Just prior to RUCO's filing of surrebuttal testimony on April 1, 2002 (a period in which RUCO was involved in settlement negotiations with Green Valley, ACC Staff and a golf course customer who had also intervened in the proceeding), the Company's parent, Fairfield Green Valley Inc. ("Fairfield"), announced its intention to sell Green Valley to the Metropolitan Domestic Water Improvement District ("Metro") of Tucson. On March 28, 2002, the Company requested a sixty-day extension in the rate case proceeding, which was granted by the Administrative Law Judge assigned to the case on April 9, 2002. Subsequently, Green Valley filed an application requesting Commission approval of the sale of the Company's assets to Metro ("Acquisition Proceeding"). Later, on May 29, 2002, Green Valley filed a motion to postpone the rate application procedural schedule in anticipation of a Commission decision regarding the proposed sale of the Company's assets.

On August 6, 2002, RUCO intervened in the proposed sale of Green Valley assets to Metro and issued data requests to determine if Metro's acquisition of Green Valley would have an adverse impact on the Company's residential ratepayers. After meeting with officers of both Metro and Green Valley in Metro's offices in Tucson, during which time both parties satisfactorily answered RUCO's questions regarding the proposed sale of assets, RUCO Staff concluded that Metro was a fit and proper entity, that the residential ratepayers would not face any adverse consequences as a result of the sale and that the proposed acquisition was in the best interest of Green Valley's residential ratepayers. RUCO then withdrew its motion to intervene in the Acquisition Proceeding.

In the months following RUCO's decision to withdraw from the Acquisition Proceeding, Green Valley residents made the decision to form the Green Valley Domestic Water Improvement District ("GVDWID"), a separate water improvement district which was approved by the Pima County Board of Supervisors, for the purpose of acquiring and locally operating the Company. The formation of GVDWID set the stage for a debate before the ACC over which competing entity (i.e. Metro or GVDWID) should be permitted to acquire the Company. A settlement agreement was eventually reached between Fairfield, Metro and GVDWID and on April 25, 2003 the ACC approved the sale and transfer of the assets of Green Valley from Fairfield to GVDWID. In addition to approving the sale of assets, ACC Decision No. 65855 also canceled Green Valley's certificate of convenience and necessity ("CC&N"), thus moving the Company out from under the regulatory authority of the ACC and ending RUCO's involvement with the rate case proceeding that had been postponed just over a year earlier.

Citizens Communications Company - Application to Change Purchased Power and Fuel Adjustment Clause Rate – Docket No. E-01032C-00-0751; Application for an increase in Arizona Gas Division rates – Docket No. G-01032A-02-0598; Joint application with UniSource Energy Corporation for approval of sale of gas and electric assets – Docket Nos. E-01933A-02-0914, E-01032C-02-0914, G-01032A-02-0914.

On September 28, 2000, the Arizona Electric Division of Citizens Communications Company ("Citizens" or "Company") filed an application (the "PPFAC Application") seeking approval to (i) change its current Purchased Power and Fuel Adjustment Clause ("PPFAC") rate, (ii) to freeze and amortize over a period of three years the balance in the existing PPFAC Bank as of September 30, 2000, (iii) to establish a new PPFAC Bank, and (iv) to begin accruing charges on the accumulated balance on over or under-recovered power supply costs.

Citizens has no significant electric generation plants, and must acquire all of the generation to meet its load from other sources. For many years, Citizens had contracted with APS to supply the power Citizens needed to serve its customers. Beginning in the summer of 2000, APS' billings to Citizens increased greatly, causing Citizens to file its PPFAC Application. APS does not maintain its own system generation to service Citizens. APS meets some of Citizens' load requirements through power purchases made on the wholesale markets. During the summer of 2000, wholesale electric prices were extremely volatile. Citizens estimated that its cost of purchased power resulted in a PPFAC bank balance deficiency of approximately \$52 million at the time it filed its application.

Citizens undertook three audits of APS' billings to determine what factors contributed to the deficiency. Citizens determined from its first two audits that there were no internal factors that contributed to the deficiency. The third audit, to determine the propriety of APS' purchases, was not been completed due to APS' not supplying requested data.

On July 16, 2001, the Company filed notice with the Federal Energy Regulatory Commission that it intended to cancel its wholesale power agreement with APS. The Company further announced that it intended to replace the current agreement with a new agreement with APS's parent company, Pinnacle West Capital Corporation ("PWCC"). The Company has since filed its new agreement with the Federal Energy Regulatory Commission and the new agreement is in place.

The progression of this case towards hearing was delayed as the result of several motions to disqualify Citizens' counsel. After resolving those motions, the matter was scheduled for hearing to commence on December 9, 2002.

On August 6, 2002, Citizens' Arizona Gas Division ("AGD") filed an application (the "Gas Rate Application") to increase rates for the AGD by \$21 million, or approximately 28.75 percent. Citizens' AGD is made up of the Northern Arizona Gas Division, which provides natural gas service to approximately 118,000 customers in portions of Coconino, Mohave, Navajo and Yavapai Counties, and a Santa Cruz Gas Division that serves approximately 7,000 customers in Santa Cruz County.

On December 18, 2002, Citizens, UniSource Energy Corporation ("UniSource"), and UniSource's subsidiary Tucson Electric Power Company ("TEP") (collectively, the "Joint Applicants") filed a joint application for approval of Citizen's sale of its Arizona electric and gas assets to UniSource and approval of related financing transactions ("Joint Application"). In the Joint Application, UniSource indicated that it was willing to forgo the balance of the PPFAC account at the time of closing, which was estimated to be approximately \$135 million, if the PPFAC base rate is adjusted to include full recovery of the costs of power under the new agreement Citizens had negotiated with PWCC. UniSource also indicated that it would attempt to renegotiate the contract with PWCC and share any resulting savings equally with customers, and offered to write down the rate base of the electric assets in the next electric rate case to reflect the price UniSource paid for those assets. UniSource also indicated in the Joint Application that it would seek a reduced increase (compared to Citizens' original application) in the Gas Rate Case of 23 percent.

The PPFAC Application, Gas Rate Application, and Joint Application were consolidated.

The Commission's Utilities Division ("Staff") and the Joint Applicants negotiated a Settlement Agreement to resolve the PPFAC Application, the Gas Rate Application and the Joint Application. Pursuant to the Settlement Agreement, UniSource would forgo recovery of the PPFAC balance at the time of closing, and the PPFAC base rate would be adjusted to fully recover the costs of the new purchased power contract with PWCC on a going forward basis. As a result of the Settlement Agreement, electric customers would experience an average increase of 22 percent. In addition, UniSource would share 60 percent of any savings resulting from renegotiation of that contract. UniSource would write down the rate base of the electric assets to its purchase price in the next electric rate case. UniSource also agreed to reduce the increase in the Gas Rate Case to 20.9 percent.

At the hearing on the Settlement Agreement, RUCO proposed that the Settlement Agreement be modified to minimize the impact of the 22% rate increase that electric customers would otherwise experience. Specifically, RUCO proposed increased expenditures in demand side management programs in the affected electric service area, and that 90 percent of any savings resulting from the renegotiation of the power contract with Pinnacle West be passed on to customers.

The Commission ultimately adopted the Settlement Agreement with some modifications, including the adoption of RUCO's proposal requiring UniSource to share 90 percent of any savings resulting from renegotiation of the power supply contract with customers.



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APPENDIX

COMMONLY-USED ACRONYMS AND TERMS

The following terms are used throughout the case summaries:

ACC – Arizona Corporation Commission
ACRM – arsenic cost recovery mechanism
AGD – Arizona Gas Division of Citizens Communications Company
ALJ – Administrative Law Judge
APS – Arizona Public Service Company
AWC – Arizona Water Company
Az-Am – Arizona-American Water Company
Bella Vista – Bella Vista Water Company
CC&N – Certificate of Convenience and Necessity
Citizens – Citizens Communications Company
CLECs – competitive local exchange carriers
Commission – Arizona Corporation Commission
DSM – demand-side management
EPA – US Environmental Protection Agency
FCC – Federal Communications Commission
FERC – Federal Energy Regulatory Commission
ILECs – incumbent local exchange carriers
MCL – maximum contaminant levels
OSS – Operational Support Systems
PPFAC – Purchased Power and Fuel Adjustment Clause
PWCC – Pinnacle West Capital Corporation (parent of APS, PWEC)
PWEC – Pinnacle West Energy Corporation
RO&O - Recommended Opinion and Order
Staff – ACC Utilities Division Staff
SWG – Southwest Gas Corporation
TEP – Tucson Electric Power Company
UniSource – UniSource Energy Corporation (parent of TEP)